

KNIFE RIVER COAL MINING COMPANY

IBLA 76-660

Decided February 8, 1977

Appeal from decision, GS-3-Mining, of the Acting Director, Geological Survey, establishing the basis for computing royalty on production from Federal coal lease BLM (ND) 019127.

Affirmed.

1. Coal Leases and Permits: Royalties

In determining the amount of royalty due to the United States under a Federal coal lease, it is proper for Geological Survey to include as part of the value basis for the purposes of computing such royalty the amount of any reimbursed state severance tax.

APPEARANCES: Joseph R. Maichel, Esq., Bismark, North Dakota, representing Knife River Coal Mining Company.

OPINION BY ADMINISTRATIVE JUDGE FISHMAN

By letter dated May 30, 1975, Knife River Coal Mining Company requested an opinion from the Geological Survey (GS) whether a severance tax (effective date July 1, 1975) imposed by the State of North Dakota would become part of the gross value of coal for computation of the royalty due the United States under Federal coal lease BLM (ND) 019127.

By letter-decision dated June 6, 1975, the Area Mining Supervisor, GS, concluded that where the selling price received at point of delivery increases by the amount of the severance tax, a proportionate amount becomes part of the value basis for computing Federal royalties. 1/

1/ We are informed by the Geological Survey that appellant is paying royalties to it on a base which includes the severance tax under protest.

Knife River appealed to the Director, GS, and on April 18, 1976, the Acting Director, GS, issued a decision affirming the Area Mining Supervisor. The Acting Director concluded:

The Government is entitled to its royalty on the gross value of the production from the lease. We have determined that the gross value for the computation of Federal royalty in this case must include the reimbursed severance tax as part of the purchase price for production from the leasehold. The Area Mining Supervisor's method of computing royalty due the United States conforms fully with the terms of the lease.

There is no factual dispute involved in the present case. The issue concerns the severance tax imposed by the State of North Dakota upon all coal severed for sale or for industrial purposes by coal mines within the State and the effect of such tax on the valuation of the coal for purposes of computation of the royalty due the United States.

The pertinent part of the royalty clause in the lease in question reads as follows:

(2d) Royalty. To pay the lessor a royalty of 5 percent of the gross value of the coal mined hereunder at the point of shipment to market, such point of shipment to be the mine or preparation plant as the case may be, but in no event will the royalty be less than 15 cents on every ton of 2,000 pounds of coal mined for the first 10 years and not less than 17-1/2 cents on every ton of 2,000 pounds of coal mined for the remainder of the second 20-year period of the lease. The lessee agrees that the Secretary of the Interior, for the purpose of determining the royalties due hereunder, may establish reasonable minimum values for the minerals mined, due consideration being given to the highest price paid for a part or a majority of the production of coal of like quality produced from the same general area, the price received by the lessee, posted prices, and other relevant matters. Royalties shall be payable quarterly within 30 days from the expiration of the quarter in which the coal is mined.

Appellant contends that the severance tax should not be considered as part of the gross value of coal for purposes of royalty computation. Appellant argues that royalty should not be computed based on the total cost of producing the coal involved, including state taxes, but rather based on the selling price of the coal.

Appellant seemingly ignores the fact that GS has never stated that gross value for royalty purposes should be computed based on the total cost of producing coal.

GS's interpretation of the value of leasehold production, as contained in the Acting Director's decision, is as follows:

If the forces in the market place determine that the value of the leasehold production at the point of shipment is no more than the 'selling price' prior to the imposition of the severance tax, the producer absorbs the severance tax in the same way that he absorbs all other increases in his operating costs.

When the producer absorbs the tax, the Federal lessee continues to compute the royalty due the United States on a basis that is not less than the 'selling price' in effect prior to the imposition of the severance tax.

Should the forces in the market place demonstrate that the value of the leasehold production at the point of shipment is actually more than the 'selling price' prior to the imposition of the severance tax, the purchaser may recognize that higher value by absorbing part or all of the severance tax in the form of an increased payment, i.e. an increase in the 'selling price' for the production from the leasehold.

When the purchaser recognizes by an increase in the 'selling price' the higher value of the leasehold production, the lessee is required to compute the royalty due the United States on the basis of that higher value, i.e. a Federal lessee must compute the royalty due the United States on a basis which is not less than the increase in the 'selling price.'

[1] Appellant charges that the tax adds nothing to the value of the coal and, therefore, the addition of the tax to the value of the coal for purposes of computing the royalty due the United States results in a windfall profit to the United States. However, a similar case involving the determination of royalty due to the United States from production of natural gas, Wheless Drilling Company, 13 IBLA 21 (1973), affirmed a GS determination establishing a unit value consisting of the field price plus the amount of the severance tax reimbursed by the buyer. Appellant states that the Wheless case "is simply a Department of the Interior decision and, in my

opinion, it is not controlling on the Department nor is that opinion applicable hereto." On the contrary, we find that the Wheless case is applicable and the rationale of that case apposite to this case.

In Wheless, supra at 32, the Board stated:

Likewise, we do not assent to the proposition that the computation of federal royalty on the gross proceeds, consisting of the gas purchase price plus the reimbursed severance tax, creates unjust enrichment of the Government's royalty interest. The Government is entitled to its royalty on the 'reasonable value' of the gas as set by the Secretary, which by regulation may not be less than the highest gross price received for similar gas. We have determined that the base value for computation of the federal royalty in this case must include both the gas purchase price and the reimbursed severance tax.

We are in agreement with the method of computing royalty in this case established by the Area Mining Supervisor and affirmed by the Acting Director, GS, and we find that reimbursed state severance tax must become part of the value basis for computing Federal royalties.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Frederick Fishman
Administrative Judge

We concur:

Martin Ritvo
Administrative Judge

Edward W. Steubing
Administrative Judge

